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IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

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JORDANOS', INC., Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

---

MADLINE F. JORDANO, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

---

HOWARD H. KING and DELFINA I. KING, Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

---

HELEN M. JORDANO, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

---

ON PETITIONS FOR REVIEW OF THE DECISIONS  
OF THE TAX COURT OF THE UNITED STATES

---

BRIEF FOR THE RESPONDENT

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IN THE UNITED STATES COURT OF APPEALS

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No. 21,894

JORDANOS', INC., Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

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No. 21,894A

MADLINE F. JORDANO, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

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No. 21,894B

HOWARD H. KING and DELFINA I. KING, Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

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No. 21,894C

HELEN M. JORDANO, Petitioner

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COMMISSIONER OF INTERNAL REVENUE, Respondent

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ON PETITIONS FOR REVIEW OF THE DECISIONS  
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OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court

(I-R. 74-88) are not officially reported.



## JURISDICTION

These petitions for review (I-R. 108-128) involve federal income taxes for the taxable years 1958 through 1961. On July 29, 1964, the Commissioner of Internal Revenue mailed to the taxpayers notices of deficiency, asserting deficiencies in those taxes in the taxable years 1958 through 1961 in the aggregate amount of \$25,121.30. (I-R. 7-13, 22-27, 35-40, 48-54.) Within ninety days thereafter, on October 26, 1964, the taxpayers filed petitions with the Tax Court for a redetermination of those deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954. (I-R. 1-13, 18-27, 31-40, 44-54.) The decisions of the Tax Court were entered on January 23, 1967. Pursuant to these decisions, the asserted deficiencies were redetermined in the aggregate amount of \$23,914.01. (I-R. 89, 95, 101, 107.) These cases are brought to this Court by petitions for review mailed April 20, 1967 (I-R. 113), within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. 1/ Jurisdiction is conferred on this Court by Section 7482 of that Code.

## QUESTION PRESENTED

Whether the Tax Court correctly held that the payments by the closely-held family corporation to the shareholding widows constituted dividends.

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1/ Under the Code, timely mailing is the equivalent of timely filing. See Section 7502 of the Internal Revenue Code of 1954.

STATUTES INVOLVED

Internal Revenue Code of 1954:

SEC. 102. GIFTS AND INHERITANCES.

(a) General Rule.--Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.

\* \* \* \* \*

(26 U.S.C. 1964 ed., Sec. 102.)

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) In General.--There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including--

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

\* \* \* \* \*

(26 U.S.C. 1964 ed., Sec. 162.)

SEC. 316. DIVIDEND DEFINED.

(a) General Rule.--For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders--

(1) out of its earnings and profits accumulated after February 28, 1913, or

\* \* \* \* \*

(26 U.S.C. 1964 ed., Sec. 316.)

SEC. 404 [as amended by Sec. 24, Technical Amendments Act of 1958, P.L. 85-866, 72 Stat. 1606]. DEDUCTION FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN.

(a) General Rule.--If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan



deferring the receipt of such compensation, such contributions or compensation shall not be deductible under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income; but, if they satisfy the conditions of either of such sections, they shall be deductible under this section, subject, however, to the following limitations as to the amounts deductible in any year:

\* \* \* \* \*

(5) Other plans.--In the taxable year when paid, if the plan is not one included in paragraph (1), (2), or (3), if the employees' rights to or derived from such employer's contribution or such compensation are nonforfeitable at the time the contribution or compensation is paid.

\* \* \* \* \*

(26 U.S.C. 1964 ed., Sec. 404.)

#### STATEMENT

The facts, as found by the Tax Court (I-R. 76-82), are as follows:

Jordanos', Inc. (herein referred to as the Corporation) was incorporated on January 28, 1946, under the laws of California. It has its principal place of business at 35 West Canon Perdido Street, Santa Barbara, and it filed its corporation income tax returns for the taxable years involved herein with the District Director of Internal Revenue, Los Angeles, California. It regularly keeps its books and records and reports its income for federal income tax purposes on an accrual method of accounting. (I-R. 76.)

Helen M. Jordano is an individual residing at Rosario Park, Star Route, Santa Barbara, California. Madeline F. Jordano is an individual residing at 1625 Overlook Lane, Santa Barbara, California.



Howard H. King 2/ and Delfina I. King are husband and wife residing at 1217-B East Cota Street, Santa Barbara, California. All the individual taxpayers filed their respective income tax returns on the cash basis for the taxable years involved herein with the District Director of Internal Revenue at Los Angeles, California. (I-R. 76-77.)

The corporation is a final successor to a partnership started by four brothers, Dominic Jordano, Frank James Jordano, Sr., John Jordano, Sr., and Peter Jordano, about 40 years ago. Each brother continued active in the business until his death. The business consists of the ownership and operation of a chain of grocery stores and acting as a wholesaler of meat and produce, as well as beer. (I-R. 77.)

Since its inception, the entire business (save for unimportant minority interests) has been owned and controlled by the Jordano families. With the exception of 1,000 shares of non-voting preferred stock, at all relevant times the Jordano brothers, their wives, their children, and trusts for their benefit have owned practically all of the common stock of the corporation. 3/ Each of the four

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2/ Howard H. King is a party to this proceeding only by reason of having filed joint returns with Delfina I. King. (I-R. 76.)

3/ In June, 1947, the four families owned 600 shares, constituting all of the issued and outstanding shares. In January, 1957, there was a 20-for-1 split. During the taxable years, the four families owned 11,060 shares. No explanation was submitted with respect to the 940-share differential but the stipulation of facts states that except for the preferred shares, the corporation "has been solely owned and controlled at all times by the four Jordano brothers, or their wives and children." (Emphasis by the court.) (I-R. 77.)

family groups owned approximately the same number of shares and the widows had substantial interests within their respective family groups. 4/ (I-R. 77-78.)

Peter Jordano, one of the founding brothers, died in 1931. At his death he was a director and shareholder of a predecessor corporation. At that time, the predecessor corporation commenced monthly payments to his widow, Delfina, in the amount of \$370 per month. Delfina later married Howard H. King. (I-R. 78.)

Dominic Jordano, also a founding brother, died in 1944. At the time of his death, he was a director, shareholder, and the president of a predecessor corporation. At that time, the predecessor corporation commenced similar monthly payments of \$370 to his widow, Madeline. (I-R. 78.)

Prior to 1953 there had been no formal resolution by the board of directors of the corporation in regard to the payments to the then widows. In June, 1953, the board, noting the payments in the past to Delfina and Madeline and purporting to recognize their need for such payments, authorized continuing the payments at the same rate of \$370 per month through June 30, 1954. In December, 1955, the board ratified the payments since June 30, 1954, and authorized their continuance without definite time limit but subject to the corporation's being financially able to make them and to the approval of

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4/ The family of John, Sr., owned 2,450 shares, of which Helen had a life interest in 1,000 shares; the family of Dominic owned 2,810 shares, of which Madeline owned 1,380 shares outright; the family of Peter owned 2,800 shares, of which Delfina owned 1,360 shares outright; and the family of Frank, Sr., owned 3,000 shares. (I-R. 78.)



the stockholders, and until further action by the board. (I-R. 78-79.)

On January 20, 1956, John Jordano, Sr., a third founding brother, died. At his death he was a director, shareholder, and the president of the corporation. Shortly after his death, the corporation paid his widow, Helen, a cash payment in the amount of \$5,000. The payment was entered on the books and records of Jordanos', Inc., as "Employees Death Benefit." On February 1, 1956, the board passed a resolution authorizing payment at the rate of \$370 per month to his widow from and after April 20, 1956, also without definite time limit but terminable at the will of the corporation, and subject to stockholder approval and the corporation's being financially able to make the payments. (I-R. 79.)

None of the corporation's other managerial employees were at any time aware of the payments to the three widows. (I-R. 79.)

Since the death of John Jordano, Sr., and through the time of trial, all three widows have continued to receive payments from the corporation at the rate of \$370 per month. Prior to the years in question, the corporation had paid approximately \$115,000 to Delfina, \$58,000 to Madeline, and \$13,000 to Helen. None of the widows has included the payments in her returns filed for the years in question or for any prior years. Each contends that the payments constitute nontaxable gifts. (I-R. 79-80.)

Prior to July 1, 1953, the payments to the widows were carried on the books of the corporation as indebtedness to it. For the fiscal year ended June 30, 1954, the payments were charged directly

to earned surplus as "pension payments." For the remaining fiscal years through June 30, 1960, the payments were charged to a non-operating expense account and similarly characterized. The corporation did not claim a deduction on its income tax returns for the payments for any year before its fiscal year ended June 30, 1961. For that year it deducted the payments as a business expense. It now contends that it is entitled to a business expense deduction for each of the years in question. (I-R. 80.)

In the three board resolutions authorizing the payments, it was recited that the corporation was under no legal obligation to the widows, that the payments were "wholly gratuitous" and were "based wholly upon [the widows'] needs and their lack of other adequate means of support." In the operative parts of the resolutions, the payments were characterized as "gratuities." Though none of the widows was ever a director, at the time of each resolution the board consisted solely of the surviving founding brothers and their sons. (I-R. 80.)

The following adjusted gross income was reported on the widows' respective income tax returns (I-R. 81):

<u>Name</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>
Delfina	\$7,866	\$7,806	\$3,543
Madeline	2,091	2,182	2,854
Helen	892	3,770	642

In 1958, Delfina was 65 years old, Madeline was 63, and Helen was 54. (I-R. 81.)



The financial condition of the widows as of June 30, 1961, was approximately as follows (I-R. 81):

<u>Assets</u>	<u>Madeline</u>	<u>Delfina</u>	<u>Helen</u>
Jordanos', Inc., stock	\$138,000	\$136,000	Life interest in 1,000 shares
Other stock	37,000	5,000	None
Cash in bank	5,000	6,000	\$14,000
Loans	7,500	6,055	None
Real property	35,000	15,000	60,000
Insurance policy (face value)	None	5,000	None

The following table sets forth the gross receipts, net income, earned surplus, and dividends paid by the corporation for the taxable years after June 30, 1953 (I-R. 82):

<u>Year Ended</u>	<u>Gross Receipts</u>	<u>Net Income* after taxes</u>	<u>Earned Surplus</u>	<u>Common stock dividends</u>
6-30-54	\$ 7,811,178	\$30,032	\$420,877	\$9,344
6-30-55	8,041,630	29,393	436,611	9,088
6-30-56	8,373,592	48,797	470,071	9,088
6-30-57	8,801,346	34,645	468,589	4,500
6-30-58	10,519,276	34,376	490,590	8,848
6-30-59	13,543,719	62,959	540,166	8,848
6-30-60	15,487,069	13,798	541,072	8,848
6-30-61	16,691,678	62,469	592,109	8,848
6-30-62	20,755,624	69,938	671,298	8,848

\* Except for fiscal year ended June 30, 1954, does not include payments made to the widow petitioners.

On the basis of these evidentiary findings and other facts of record, the Tax Court made the following ultimate finding of fact (I-R. 82):

The payments to the widows constituted a distribution of earnings and profits and therefore a dividend by the Corporation to three of its major shareholders.

Accordingly, the Tax Court sustained the Commissioner's determination of deficiencies in income taxes for the taxable years, in the amounts stated above. (I-R. 82-88.)

#### SUMMARY OF ARGUMENT

In resolving the basically factual issue before it -- whether certain payments made by the corporation (a closely-held family corporation) to the recipients (shareholding widows) constitute dividends or something else -- the Tax Court determined that the payments constituted dividends. (Thus, the payments were neither deductible to the corporation nor excludable from income by the recipients.) In so doing, it took into consideration facts which, at the least, tended to show that the payments were neither business-oriented nor intended as gifts; on the contrary, the facts demonstrated that the payments were in reality dividends. The payments endured over long periods of time; they were made without limitation of time; the corporation had a poor dividend history; it possessed sufficient earnings and profits during the taxable years as a source for making the payments; and the shareholding widows and their children owned approximately 73 percent of the outstanding common stock. Whatever force, if any, there is in the taxpayers' argument before this Court, it surely is not sufficient to warrant, let alone require, a reversal on the ground that the ultimate finding of fact below is clearly erroneous.



ARGUMENT

THE TAX COURT CORRECTLY HELD THAT THE PAYMENTS BY THE CLOSELY-HELD FAMILY CORPORATION TO THE SHAREHOLDING WIDOWS CONSTITUTED DIVIDENDS. HENCE, THEY WERE NEITHER DEDUCTIBLE BY THE CORPORATION NOR EXCLUDABLE FROM INCOME BY THE WIDOWS

Whether or not a corporate distribution is a dividend or something else, such as a gift, compensation for services, repayment of a loan, interest on a loan, or payment for property purchased, represents a question of fact to be determined in each case. Commissioner v. Duberstein, 363 U.S. 278, 289; John Kelley Co. v. Commissioner, 326 U.S. 521; Union Stock Farms v. Commissioner, 265 F. 2d 712, 726, decided by this Court: Lengsfield v. Commissioner, 241 F. 2d 508 (C.A. 5th). Here the facts are not in dispute, only the inferences to be drawn therefrom. To weigh the evidence, to draw inferences from the facts, and to choose between inferences is, of course, the function of the trial court, and its determination is not to be disturbed unless clearly erroneous. Commissioner v. Duberstein, supra; United States v. Gypsum Co., 333 U.S. 364, rehearing denied, 333 U.S. 869; Union Stock Farms, supra; Lengsfield v. Commissioner, supra; Schner-Block Co. v. Commissioner, 329 F. 2d 875 (C.A. 2d).

After a full consideration of the facts, the Tax Court found that the payments were in reality dividends, and consequently they were neither deductible by the corporation nor excludable from income by the shareholding widows. This conclusion is amply supported by the facts; in any event it cannot be characterized as so clearly erroneous as to require reversal by this Court.

At the threshold, it should be borne in mind that the payments, which endured over long periods (see Carson v. United States, 317 F. 2d 370 (Ct. Cl.)), were made without limitation of time (see Schner-Block Co. v. Commissioner, supra). Instead, they were geared to the corporation's ability to pay. (I-R. 79.) Moreover, the corporation, which had a poor dividend history (I-R. 82) (see Schner-Block Co. v. Commissioner, supra), possessed sufficient earnings and profits during the taxable years as a source for making the payments. Lastly, the shareholding widows and their children owned approximately 73 percent of the outstanding common stock (I-R. 78) -- a significant point completely ignored by taxpayers. Under these circumstances, the payments in question directly respond to the definition of a taxable dividend contained in Section 316 of the Internal Revenue Code of 1954, supra.

The facts in the instant cases are strikingly similar to those in Lengsfeld v. Commissioner, supra, a case relied on by the Tax Court, yet not even cited by taxpayers. There, as here, payments were made to three shareholding widows by a closely-held corporation. Payments had been made to one widow for some 23 years, to another widow for eight years, and to the remaining widow for two years. The corporate resolutions authorizing the payments characterized them as "gratuities." The widows owned 63 percent of the common stock and the remaining shares were owned by close relatives. The corporation had substantial earnings and profits during the period involved. On these facts, the Tax Court concluded that the payments were in reality dividends. Addressing itself to the taxpayers' contention that this



conclusion was clearly erroneous, the Fifth Circuit stated (p. 510):

"We think the record supports, indeed requires, this conclusion."

See also Union Stock Farms v. Commissioner, supra; Schner-Block Co. v. Commissioner, supra; Barbourville v. Commissioner, 37 T.C. 7.

Despite the foregoing, taxpayers contend (Br. 9-13) that the payments were deductible by the corporation and excludable by the widows. These contentions were properly rejected by the Tax Court. (I-R. 83-86.) The record simply does not support taxpayers' contention that the payments were to serve as incentives or morale boosters to other managerial employees. 5/ On the contrary, as the Tax Court pointed out (I-R. 83), the other managerial employees were not even aware of the existence of these payments. Taxpayers' "gift" contention is equally without merit. 6/ Although the payments were purportedly made in recognition of the financial needs of the widows, it was stipulated that as of June 30, 1961, the widows possessed estates valued at approximately \$222,500, \$173,000 and \$74,000 (plus a life estate in 1,000 shares of common stock in the corporation), respectively. (I-R. 70, 81.) Furthermore, as noted by the Tax

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5/ Thus, taxpayer-corporations' reliance on the judicial authorities cited on page 9 of its brief is misplaced. In each of those cases, the payments were held to have been made in recognition of the services previously rendered by the decedent-employee.

Similarly, I.T. 3329, 1939-2 Cum. Bull. 153, fails to support the claimed deduction. The payments involved therein were a continuation of salary. (I.T. 3329 was modified by I.T. 4027, 1950-2 Cum. Bull. 9, with respect to the taxability of the payments to the widow.)

6/ The cases cited by taxpayers (Br. 10-12) do not support their contention. In each case, the issue was whether the widow payments constituted a gift or compensation for services.

Court (I-R. 85), the fact that the payments remained constant over such protracted periods militates against taxpayers' gift theory. 7/

In essence, taxpayers' argument amounts to nothing more than a request that this Court substitute its own finding of fact under all of the circumstances here presented for that of the Tax Court -- a most inappropriate request in any case and, particularly, in a case such as this where no error of law has been demonstrated. Since the record establishes that the Tax Court's decisions are supported not merely by substantial evidence, but by the overwhelming weight of the evidence, and the proper legal standards were applied, the decision is clearly correct.

#### CONCLUSION

The decisions of the Tax Court should be affirmed.

Respectfully submitted,

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DECEMBER, 1967.

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7/ Also, it is significant that, while the financial status of the widows varied substantially, the amount of the payment to each was identical.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: \_\_\_\_\_ day of December, 1967.

Howard M. Koff, Attorney

